

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**DEFENSE BUSINESS OPERATIONS FUND
ADJUSTMENTS AT THE DEFENSE FINANCE AND
ACCOUNTING SERVICE DENVER CENTER**

Report No. 98-050

January 20, 1998

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Department of Defense

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Acronyms

CFO	Chief Financial Officers
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
JLSC	Joint Logistics Systems Center
USTRANSCOM	U.S. Transportation Command



INSPECTOR GENERAL
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January 20, 1998

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE DENVER CENTER**

**SUBJECT: Audit Report on Defense Business Operations Fund Adjustments at the
Defense Finance and Accounting Service Denver Center
(Report No. 98-050)**

We are providing this final report for review and comment. We considered management comments on a draft of this report when preparing the final report. We audited the adjustments made at the Defense Finance and Accounting Service Denver Center as part of an overall audit of Defense Business Operations Fund financial statements. Financial statement audits are required by the Chief Financial Officers Act of 1990.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Deputy Director for Accounting, Defense Finance and Accounting Service, provided comments that are nonresponsive to Recommendation 1. Therefore, we request the Director, Defense Finance and Accounting Service, provide additional comments by March 20, 1998.

Questions on the audit should be directed to Mr. Byron B. Harbert, Audit Project Manager, at (303) 676-7405 (DSN 926-7405). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 98-050

(Project No. 5FD-2020.06)

January 20, 1998

Defense Business Operations Fund Adjustments at the Defense Finance and Accounting Service Denver Center

Executive Summary

Introduction. We reviewed documentation of adjustments made by the Defense Finance and Accounting Service (DFAS) Denver Center in preparing financial statements during our audit of the revenue accounts in the FY 1996 Defense Business Operations Fund (DBOF) financial statements. We performed the audit in response to requirements of the Chief Financial Officers Act of 1990 (Public Law 101-576, November 15, 1990), as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). On December 11, 1996, the Under Secretary of Defense (Comptroller) announced that the DBOF would be realigned into five separate working capital funds, one of which would be a Defense agencies fund with cash managed by the Defense Logistics Agency. That realignment does not affect the issues discussed in this report.

The financial statements of the DBOF for the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center were prepared by the DFAS Denver Center. The FY 1996 financial statements for those organizations showed total assets of \$37.6 billion and total revenues of \$17.8 billion. In preparing the FY 1996 financial statements, the Denver Center made 124 adjustments valued at \$227.3 billion. The adjustments were made to accommodate year-end closing entries, convert nonstandard data reported to conform to the DoD Standard General Ledger format, and correct errors. This report is the sixth in a series of reports dealing with DBOF revenue issues. See Appendix B for details of those reports.

Audit Objectives. The overall revenue accounts audit objective was to determine whether revenues reported on the FY 1996 DBOF consolidated financial statements were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this part of the audit, we reviewed documentation of adjustments to the accounting records at the DFAS Denver Center from which the financial statements were prepared. We did not evaluate the adjustments for validity. In addition, we assessed internal controls and compliance with laws and regulations as applicable to the overall audit objective.

Audit Results. The DFAS Denver Center did not have adequate supporting documentation, in accordance with DoD 7000.14-R, "DoD Financial Management Regulation," for 111 adjustments totaling \$217.5 billion made to the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center FY 1996 DBOF account balances. The last nine adjustments without supporting documentation brought the Air Force DBOF Results of Operations from a loss of \$11 billion to a gain of \$2.2 billion,

and the lack of audit trails contributed to the disclaimed audit opinion for the FY 1996 DBOF financial statements. In many instances, adjustments were made to the same accounts because the adjustments were recorded incorrectly, reversed, reestablished, decreased, or increased. However, we could not determine the validity of the adjustments because of the lack of supporting documentation. As a result, the FY 1996 DBOF financial statements of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center were subject to higher risk for material misstatement. For details of the audit results, see Part I.

By implementing the recommendations made in this report, the Defense Finance and Accounting Service can ensure that adjustments made to financial records are valid, accurate, and supported. For details on the management control program, see Appendix A.

Summary of Recommendations. We recommend that the Director, Defense Finance and Accounting Service, issue written guidance for making adjustments. We also recommend that the Director, Defense Finance and Accounting Service Denver Center, establish procedures to ensure that adequate explanation and supporting documentation are provided for adjustments.

Management Comments. The DFAS Deputy Director for Accounting (the Deputy Director) provided comments that partially concurred with the finding, nonconcurred with the recommendation to issue written guidance for making adjustments, and partially concurred with the recommendation to establish procedures at the DFAS Denver Center for making adjustments. The Deputy Director stated that all but 20 of the 111 adjustments were supported by documentation. The Deputy Director also stated that the IG, DoD, did not provide any evidence that the adjusting journal vouchers were either inaccurate or required. See Part I for a complete discussion of management comments and Part III for the complete text of management comments.

Audit Response. The Deputy Director comments did not acknowledge the basic requirement that adjusting journal vouchers must be supported with documentation; otherwise, the financial statements cannot be relied upon as presenting accurate and valid information. The burden of proof rests with management, not audit, for the accuracy and validity of the financial statements and underlying accounting records. When management does not document adjustments to the accounting records, auditors have no way of knowing whether those adjustments are accurate and valid. The Deputy Director comments are also nonresponsive to the recommendation to issue written guidance. The fact that written guidance issued by DFAS must be approved by the Office of the Under Secretary of Defense (Comptroller) does not prevent DFAS from drafting guidance and requesting the required approval. We request that the Director, DFAS, reconsider the DFAS position on the finding and on the recommendation to issue written guidance, and respond to the final report by March 20, 1998.

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Part I - Audit Results

Audit Background

We completed this audit as part of our audit of "Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund" (the revenue accounts audit). The revenue accounts audit was performed to meet the requirements of the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576, November 15, 1990) as amended by the Federal Financial Management Act of 1994 (Public Law 103-356, October 13, 1994). The CFO Act requires DoD to prepare annual, audited financial statements and submit them to the Office of Management and Budget. These financial statements report the financial position and results of operations of the Defense Business Operations Fund (DBOF) Components and other DoD reporting entities.

This is the sixth in a series of reports on issues related to revenues in the DBOF. See Appendix B for details of those reports.

In December 1996, the Office of the Under Secretary of Defense announced that the Defense Business Operations Fund would be realigned into five separate working capital funds, including a Defense agencies fund. That realignment does not affect the issues raised in this report.

The Role of the DFAS Denver Center. The DFAS Denver Center provides accounting and financial statement preparation services to the Department of the Air Force, U.S. Transportation Command (USTRANSCOM), and the Joint Logistics Systems Center (JLSC). These DoD Components submit accounting data to the DFAS Denver Center for preparation of the financial statements and other reporting purposes. The FY 1996 financial statements of the Defense Business Operations Fund for the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center, reported total assets of \$37.6 billion and total revenues of \$17.8 billion.

In preparing the FY 1996 financial statements, the Denver Center processed 124 adjustments valued at \$227.3 billion to the Department of the Air Force, U.S. Transportation Command (USTRANSCOM), and the Joint Logistics Systems Center (JLSC) accounting records. The adjustments were made to accommodate year-end closing entries, convert nonstandard data reported to conform to the DoD Standard General Ledger format, and correct errors.

CFO Reporting System. In 1995, DFAS Denver Center established the CFO Act Compliance Program Project, under which the CFO Reporting System was developed. The project was established to find a better way for the Denver Center to meet its financial reporting requirements. Before the CFO Reporting System was established, the Denver Center prepared Air Force financial statements manually. The CFO Reporting System was developed to document and expedite (through automation) the process used by the Denver Center to prepare the Air Force financial statements.

DoD Policy. DoD 7000.14-R, DoD Financial Management Regulation, requires DFAS to support adequately and justify in writing, any adjustment to the official accounting records. The Regulation prescribes that documentation should consist of evidence that supports the need to correct the error and adjust

the balances in sufficient detail to provide an audit trail to the source transaction(s) that requires the adjustment. In addition, the Regulation requires that the rationale for the adjustment be provided. The rationale for the adjustment is needed on the adjusting journal voucher to explain the purpose of the adjustment and why it is being made.

Audit Objectives

The overall revenue accounts audit objective was to determine whether revenues reported on the FY 1996 DBOF consolidated financial statements were presented fairly in accordance with the "other comprehensive basis of accounting" described in Office of Management and Budget Bulletin No. 94-01, "Form and Content of Agency Financial Statements," November 16, 1993. For this part of the audit, we reviewed documentation of adjustments to most accounting records, including revenue, at the Defense Finance and Accounting Service Denver Center, from which the financial statements were prepared. We did not evaluate validity of the adjustments. In addition, we assessed internal controls and compliance with laws and regulations as applicable to the overall audit objective. See Appendix A for a discussion of the audit scope, methodology, and management control program.

Controls Over DBOF Adjustments at DFAS Denver Center

The DFAS Denver Center did not have adequate supporting documentation for 111 adjustments totaling \$217.5 billion made to the FY 1996 DBOF account balances of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center. In addition, for 90 of the 111 adjustments without adequate supporting documentation, the DFAS Denver Center did not develop an adequate written explanation for the adjustments. In many instances, adjustments were made to the same accounts because the adjustments were recorded incorrectly, reversed, reestablished, decreased, or increased. The last nine adjustments without supporting documentation brought the Air Force DBOF Results of Operations from a loss of \$11 billion to a gain of \$2.2 billion, and the lack of audit trails contributed to the disclaimed audit opinion on the FY 1996 DBOF financial statements. However, we could not determine the validity of the adjustments because of the lack of supporting documentation. These conditions existed because the DFAS Denver Center did not have adequate management controls over the processing of adjusting journal entries. In addition, DFAS had not provided adequate written guidance for preparing adjusting journal entries. As a result, the FY 1996 DBOF financial statements of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center were subject to higher risk for material misstatement.

Adjustments Made by DFAS Denver Center

FY 1996 DBOF Financial Statements. The DoD Deputy Chief Financial Officer provided the proposed FY 1996 Consolidated DBOF Financial Statements to the Inspector General, DoD, on March 24, 1997. The proposed statements reported a loss of \$16 billion for DBOF operations, which included a reported loss of \$11 billion for the Air Force. We received the final statements on May 12, 1997, although they were dated March 1, 1997.

Financial Statement Preparation. The DFAS Denver Center prepared the portions of the DBOF financial statements for the Air Force, USTRANSCOM, and JLSC. After the Deputy Chief Financial Officer submitted the proposed statements to the Inspector General, DoD, officials at DFAS Denver Center discovered errors in previous adjustments. Accordingly, DFAS Denver Center officials made additional adjustments and prepared revised financial statements, which were subsequently published. A major difference between the proposed and final versions of the financial statements was that the Air Force results of operations changed from a loss of \$11 billion to a gain of \$2.2 billion, as a result of the last nine adjustments.

The financial statements reported total assets of \$37.6 billion and total revenues of \$17.8 billion for the three Defense Components. In preparing the FY 1996 financial statements, the DFAS Denver Center made at least 124 adjustments to

Controls Over DBOF Adjustments at DFAS Denver Center

Air Force, USTRANSCOM, and JLSC financial data totaling \$227.3 billion as shown in Table 1.

Table 1. Component Adjustments

<u>Component</u>	<u>Number of Adjustments</u>	<u>Amount (millions)</u>
Air Force	71	\$221,792
USTRANSCOM	48	5,088
JLSC	5	373
Total	124*	\$227,253

*These adjustments were to individual line balances on the statements and to account balances.

Purpose of Adjustments. The 124 adjustments were related to 8 different accounting categories:

- o closing adjustments that placed selling expense account balances into the cost of goods sold account balance;
- o crosswalk adjustments that corrected errors converting financial data from the Air Force chart of accounts to the DoD chart of accounts;
- o reversing adjustments that removed the effect of selected adjustments made to the FY 1995 financial statements;
- o correcting adjustments that corrected or eliminated other adjustments that contained errors;
- o reclassifying adjustments that reidentified revenue and cost of goods sold account balances as either applicable to public or Government sources;
- o direct line adjustments that revised data applicable to specific lines on financial statements (The Statement of Cash Flow) without adjusting account balances and corrections to previous direct line adjustments that contained errors;
- o eliminating adjustments that removed the effect on revenues, cost of goods sold, accounts receivable, and accounts payable account balances for transactions between DBOF entities; and
- o other miscellaneous adjustments.

Adjustment categories and the related dollar amounts are shown in Table 2.

Controls Over DBOF Adjustments at DFAS Denver Center

Table 2. Adjustment Categories

<u>Adjustment Category</u>	<u>Number of Adjustments</u>	<u>Amount (millions)</u>
Closing	10	\$11,071
Crosswalk	6	62,044
Reversing	8	504
Correcting	37	56,343
Reclassifying	13	16,763
Direct line	44	73,818
Eliminating	4	6,056
Other	8	654
Total	130*	\$227,253

*Six adjustments were assigned to two different categories. One adjustment was assigned to both direct line adjustments and corrections and to other adjustments. Five adjustments were assigned to closing adjustments and to reclassifying adjustments.

Controls. The DFAS Denver Center did not adequately control the process for making adjustments to the accounts and to the financial statement line item balances. Controls were not implemented to ensure that adequate documentation supported the adjustments and journal vouchers supporting the adjustments were adequately accounted for. In addition, DFAS had not provided specific guidance to operating personnel for making and controlling adjustments.

Supporting Documentation. Of the 124 adjustments made by DFAS Denver Center to the FY 1996 DBOF financial statements, 111 did not contain supporting documentation and 90 were not adequately explained. DFAS Denver Center did have supporting documentation for 13 of the adjustments made. However, none of the remaining 111 adjustments were supported by documentation that met the DoD 7000.14-R criteria. Additionally, although reasonably adequate explanations existed for 21 of the 111 adjustments without supporting documentation, the adjusting journal vouchers for the remaining 90 adjustments did not contain an adequate explanation of the purpose for the adjustment.

Additionally, a contractor developing the CFO Reporting System was allowed to make adjustments. One adjustment for FY 1996 business activity of approximately \$700 million was made by the contractor without approval by a DFAS official. In addition, 70 adjustments for FY 1995 business activity of over \$49 billion were also made by the contractor without DFAS approval. Officials at DFAS Denver Center stated that as long as the system is under development, the contractor will have to make adjustments.

The need for better control of adjustments is provided in the following example showing a series of adjustments.

Controls Over DBOF Adjustments at DFAS Denver Center

- o Adjusting journal voucher number D96081 recorded a transaction of \$19.2 billion to the cash flow statement.
- o Journal voucher number D96083 reversed D96081.
- o Journal voucher number D96099 reestablished the adjustment, debiting and crediting different accounts and changing the amount of the adjustment to \$12.7 billion.
- o Journal voucher number D96100 reduced D96099 by \$.3 billion.
- o Journal voucher number D96102 also recorded a \$12.7 billion adjustment to the accounts adjusted in D96081.

Had adequate supporting documentation been provided, the appropriate adjustment could have been made in one entry. Instead, no assurance exists that the correct adjustment has yet been made. Additional instances were identified of similar adjustments that were reversed or corrected numerous times.

Accountability for Journal Vouchers. The Journal Voucher Report, which is produced by the CFO Reporting System and should list all adjustments made, did not account for all journal voucher identification numbers. Each journal voucher number assigned to identify an adjustment should sequentially follow the last number used. Otherwise, an unauthorized adjustment could be entered into the system and have a greater chance of not being detected. The Journal Voucher Report for adjustments to FY 1996 DBOF business activity omitted seven voucher numbers, five of which were subsequently located. Later, a sixth journal voucher was located. DFAS Denver Center officials stated that the other voucher number was not used. The CFO Reporting System should have controls that would prevent the assignment of journal voucher numbers out of sequence and also ensure that all journal voucher numbers assigned are accounted for in the Journal Voucher Report.

Guidance. DFAS Headquarters and the DFAS Denver Center did not provide adequate written guidance to operating personnel for making adjustments at the DFAS centers. Instructions to staff accountants were needed for providing explanations for the adjustments; providing adequate supporting documentation; providing evidence of supervisory reviews; and ensuring voucher number integrity.

Summary

The DFAS Denver Center did not have adequate controls over the processing and review of 111 DFAS Denver Center adjusting journal entries, valued at \$217.5 billion, for financial records and financial statements. For 90 of the 111 adjustments without supporting documentation, the DFAS Denver Center did not develop an adequate written explanation for the adjustments. Many of the adjustments were made to the same accounts. This occurred because the adjustments were recorded incorrectly, reversed, reestablished, decreased, or

Controls Over DBOF Adjustments at DFAS Denver Center

increased. We did not determine the validity of the adjustments because of the lack of documentation. The DFAS Denver Center needed to develop adequate management controls over the processing of adjusting journal entries and provide adequate written guidance for preparing adjusting journal entries. The FY 1996 DBOF financial statements of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center were subject to higher risk for material misstatement because of the adjustments. Also, the last nine adjustments without supporting documentation brought the Air Force DBOF Results of Operations from a loss of \$11 billion to a gain of \$2.2 billion. The condition was one of several significant reasons why we issued a disclaimer of opinion on the FY 1996 Consolidated DBOF financial statements.

Management Comments on the Finding and Audit Response

Management Comments. The DFAS Deputy Director for Accounting (the Deputy Director) provided comments that partially concurred with the finding and agreed that improvements in management controls over adjustments were required. However, the Deputy Director stated that all but 20 of the 111 adjustments were supported by documentation. The Deputy Director also stated that the IG, DoD, implied that erroneous balances existed; the IG, DoD, could not determine the validity of the vouchers; and the IG, DoD, did not provide any evidence that the vouchers were either inaccurate or required. The Deputy Director also stated, "To our knowledge, the IG, DoD, did not request or examine the supporting documentation for the last nine journal vouchers that are in the report." The Deputy Director also noted that the net effect of all 124 vouchers that were processed was a reduction of \$6 billion in assets, an increase of \$185.6 million in liabilities and a reduction of \$6.3 billion in equity.

The Deputy Director nonconcurred that adjustments were made by the system development contractor without approval by DFAS officials. The Deputy Director also nonconcurred that a recommendation from Audit Report No. 97-081, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," was not implemented. The Deputy Director provided a copy of an Office of the Under Secretary of Defense (Comptroller) memorandum indicating that the FY 1995 Statement of Cash Flows had been restated to add \$940 million to the line for Appropriations.

Audit Response. We consider the Deputy Director comments to be nonresponsive to the finding. Throughout his comments, the Deputy Director attempts to discredit the auditors rather than acknowledge problems and take necessary actions to correct them. Although the Deputy Director agreed that improvements in management controls over the processing of adjustments at the DFAS Denver Center were required to ensure that all adjustments are adequately documented, he disagreed that the adjustments were not supported. The Deputy Director stated that supporting documentation existed for all but 20 of the 111 adjustments; however, neither he nor DFAS Denver Center officials have made that documentation available for our review. During the audit, we asked staff accountants at the DFAS Denver Center where we could find the documentation supporting the adjustments. All but one accountant stated that

Controls Over DBOF Adjustments at DFAS Denver Center

whatever documentation existed was attached to the voucher. The other accountant stated that his documentation was in a box of records, commingled with many other types of records, which he had given to the Acting Branch Chief, Business Fund and Interfund Branch, Accounting and Reporting Division, DFAS Denver Center (the Acting Branch Chief). The Acting Branch Chief confirmed to us the lack of documentation on several occasions. In addition, he acknowledged receipt of two boxes of records from an accountant and stated that he did not have time to go through the boxes to locate the supporting documentation prepared by that accountant. Later, after the last nine adjustments were made, we asked the Acting Branch Chief for the documentation supporting those adjustments. He informed us that no documented support existed for those adjustments. Therefore, we disagree with the Deputy Director's statement that all but 20 of the 111 vouchers were supported by documentation. That documentation, if it existed, could have been provided to us at any time by DFAS Denver Center officials. However, despite our repeated requests, documentation was not made available for our review for 90 of the 111 adjustment vouchers. Further, when we briefed the Director, DFAS Denver Center, on June 9, 1997, we noted the lack of documentation or support for the 90 adjustments. He did not then, or later, provide any of the missing documentation to us, although he too said it existed. Consequently, we can only conclude that documentation did not exist.

The Deputy Director stated that our report implied that erroneous balances existed, yet we did not provide any evidence that the adjusting journal vouchers were inaccurate. The Deputy Director comment does not address the core issue that adjusting journal vouchers must be supported; otherwise, the financial statements cannot be relied upon as presenting accurate and valid information. The burden of proof rests with management, not audit, for the accuracy and validity of the financial statements and underlying accounting records. When management does not document adjustments to the accounting records, auditors have no way of determining whether those adjustments are accurate and valid. Further, even though the net effect of the 124 vouchers (adjusting entries of \$217.5 billion) resulted in only \$6 billion in asset and liability balances, accuracy and reliability come into question when the adjusting entries underpinning that net adjustment cannot be supported with sufficient documentation.

The Deputy Director's statement that adjustments made by the contractor were approved by DFAS officials overlooks the fact that there was no documentation of such approval.

The Deputy Director nonconcurred with our conclusion regarding the implementation of our recommendation in Audit Report No. 97-081 (See Appendix B, Page 16). We recommended that the FY 1995 Appropriated Capital Used balance be restated in the FY 1996 comparative financial statements. Appropriated Capital Used is a revenue and other financing sources account in the Statement of Operations and Changes in Net Position. Instead, the memorandum provided by the Deputy Director describes action taken to restate the Appropriations account in the Statement of Cash Flows. While that change also needed to be made, no action was taken to restate the Appropriated

Controls Over DBOF Adjustments at DFAS Denver Center

Capital Used account in the Statement of Operations and Changes in Net Position as we recommended.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Defense Finance and Accounting Service, issue written guidance for making adjustments. Such guidance should include procedures for providing:

- a. Adequate descriptions of the purposes for the adjustments.**
- b. Adequate supporting documentation.**
- c. Control and accountability for the assignment of journal voucher numbers.**

Management Comments. The Deputy Director nonconcurred, stating that existing guidance was adequate. The Deputy Director suggested we redirect that recommendation to the Office of the Under Secretary of Defense (Comptroller) because any written guidance issued by DFAS would have to be approved by the Office of the Under Secretary of Defense (Comptroller).

Audit Response. The Deputy Director comments are nonresponsive. During the audit, DFAS Denver Center accountants informed us that they had no guidance on making adjustments. They also informed us that their only training was a brief explanation given by the previous branch chief. Although the Deputy Director observed that written guidance issued by DFAS must be approved by the Office of the Under Secretary of Defense (Comptroller), that does not prevent DFAS from drafting guidance and requesting the required approval. Even though the Deputy Director acknowledges (in comments to the finding) that training will be undertaken to ensure that all personnel responsible the preparation and approval of journal vouchers have a clear understanding of the requirements, written guidance is needed to prevent future use of unsupported adjusting journal vouchers. The Deputy Director is requested to reconsider his position on the finding and recommendation and provide comments by March 20, 1998.

2. We recommend that the Director, Defense Finance and Accounting Service Denver Center, establish procedures to ensure that:

- a. Adequate descriptions are provided for all adjustments made.**
- b. Adequate supporting documentation is provided for all adjustments made. Such documentation should include sufficient evidence to provide an audit trail to the source transaction(s) requiring the adjustment.**

c. Adjusting journal voucher entries are numbered consecutively and all voucher identification numbers used are accounted for.

Management Comments. The Deputy Director partially concurred with the recommendation, stating that although he does not believe DFAS has a significant problem documenting adjustments, DFAS will establish procedures to implement the recommendation.

Audit Response. We consider the Deputy Director comments to be responsive to the recommendation because the proposed actions will accomplish the objectives of the recommendation. Therefore, no further comments are required.

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Part II - Additional Information

Appendix A. Audit Process

Scope

As part of our audit of "Revenue Accounts in the FY 1996 Financial Statements of the Defense Business Operations Fund," we reviewed documentation of adjustments made in preparing those financial statements. Specifically, we reviewed documentation of 124 adjustments to the FY 1996 accounting records totaling \$227 billion. We did not evaluate those adjustments for validity.

Methodology

We performed this financial-related audit at the Defense Finance and Accounting Service Denver Center, from February through May 1997. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD, and Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993. We did not evaluate the general and application controls of the CFO Reporting System that summarizes data reported by other systems of the Air Force, USTRANSCOM, or JLSC, although we relied on data produced by those systems to conduct the audit. Not evaluating the controls did not affect the results of the audit. We included such tests of management controls as we considered necessary.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed management control procedures regarding the preparing of adjustments to the accounts and to the financial statement line items. We also reviewed management's self-evaluation of those management controls.

Adequacy of Management Controls. We identified a material management control weakness as defined by DoD Directive 5010.38 relating to the preparation of adjustments to the accounts and financial statement line items. Adequate controls had not been established to ensure the accuracy of financial information presented in the financial statements. Recommendations 1. and 2.,

if implemented, will provide the needed controls for ensuring the validity and accuracy of financial statements. A copy of the report will be provided to the senior DFAS official responsible for management controls.

Adequacy of the Defense Finance and Accounting Service Denver Center Self-Evaluation. Denver Center officials did not identify adjustments as an assessable unit and, therefore, did not identify or report the management control weakness identified by the audit.

Appendix B. Summary of Prior Coverage

Inspector General, Department of Defense

The Inspector General, Department of Defense, previously issued five reports on issues identified during the audit of the revenue accounts in the FY 1996 Defense Business Operations Fund financial statements:

Report No. 97-091, "Revenue Recognition Policies for the Army Defense Business Operations Fund," February 12, 1997. This report states that the Army plans to update the Standard Industrial Fund System to meet DoD 7000.14-R revenue recognition requirements that will be superseded by Office of Management and Budget Statement of Federal Financial Accounting Standards Number 7 on October 1, 1997. As a result, DoD will needlessly spend approximately \$45,000 to reconfigure the Standard Industrial Fund System to meet outdated requirements and fail to address a potential impediment to a favorable financial statement audit opinion. We recommended that the Under Secretary of Defense (Comptroller) advise the Army Industrial Operations Command to suspend making the system change until it has been determined how DoD will implement the Office of Management and Budget revenue recognition standard for contracts. The Deputy Chief Financial Officer nonconcurred with the recommendation. As a result of mediation, the issue was reviewed by the Working Capital Fund study group. The study group concluded that the Under Secretary of Defense (Comptroller) should take the action recommended in the audit report.

Report No. 97-081, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," January 27, 1997. This report states that the FY 1995 DBOF consolidated financial statements did not correctly report the appropriated funds used by DBOF for commissary operations. As a result, the FY 1995 DBOF financial statements understated revenues and financing sources by \$940 million and overstated the shortage of revenues and financing sources over expenses by a like amount. We recommended that the Under Secretary of Defense (Comptroller) rescind an erroneous policy instruction and ensure that future instructions adhere to established DoD policy. We also recommended that the Director, Defense Finance and Accounting Service, correct the FY 1995 error in the FY 1996 comparative financial statements. Although the Deputy Chief Financial Officer agreed to the recommendations, the FY 1996 comparative financial statements did not include a correction of the FY 1995 error. As a result, the FY 1996 comparative financial statements were misleading.

Report No 97-040, "Distribution Depot Over-Ocean Second Destination Transportation Costs," December 10, 1996. This report states that transportation costs applicable to other DoD organizations were erroneously charged to the Distribution Depot business area of the Defense Business Operations Fund. Our review of three summary bills of 104,878 shipments, totaling \$26.8 million, showed that \$10.5 million (39 percent) was erroneously

charged to the Distribution Depot business area. After our review, a management consulting firm hired by the DLA found an additional \$41.8 million (27 percent) of \$155.7 million paid from April 1995 through March 1996 was not applicable to the Distribution Depot business area. As a result, the Distribution Depot business area paid for material amounts of transportation costs that should have been paid by other DoD organizations. In FY 1995, the Distribution Depot business area lost \$102 million in over-ocean second destination transportation costs; this loss was caused partly by erroneous bills. We recommended that the Director, DLA, change the payment policy to required the Defense Distribution Regions to pay only those charges applicable to the Distribution Depot business area. Management actions planned were responsive to the recommendations.

Report No. 96-198, "Defense Logistics Agency Revenue Eliminations," July 22, 1996. This report states that when the DLA made sales to other organizations that are part of the DBOF, revenues from these sales were not eliminated from the amount reported in the FY 1995 financial statements, as required by Under Secretary of Defense (Comptroller) guidance. Consequently, revenue of \$13.3 billion, reported by DLA in the FY 1995 Consolidated Financial Statements of the DBOF, was overstated by \$8.4 billion (63 percent). Revenue was also overstated by \$.6 billion in the DLA financial statements. We recommended that the Defense Finance and Accounting Service establish procedures to eliminate revenues from sales to intrafund customers when preparing financial statements of the Defense Business Operations Fund. We also recommended that DLA review, identify, and request correction of any deficiencies in the proposed financial statements. Management actions planned were responsive to the recommendations.

Report No. 96-160, "Defense Business Operations Fund Equity Transfer--Defense Commissary Agency," June 13, 1996. This report states that at the direction of an official in the Office of the Under Secretary of Defense (Comptroller), the Defense Commissary Agency erroneously reported a \$251.6 million transfer of equity from the DLA segment of the DBOF as revenue in the FY 1995 financial statements. As a result, revenues and net results of operations were overstated by \$251.6 million in the FY 1995 consolidated financial statements of the DBOF. We recommended that the FY 1995 financial statements be corrected and that only appropriate officials be allowed to issue accounting policy. After initially nonconcurring with the finding that an equity transfer was not revenue, the Deputy Chief Financial Officer later agreed to correct the FY 1995 financial statements.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Director (Audit Liaison and Follow Up)
Auditor General, Department of the Air Force

Unified Commands

Commander in Chief, U.S. Transportation Command

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency
Joint Logistics Systems Center

Non-Defense Organizations

Office of Management and Budget

Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional
committees and subcommittees:

Senate Committee on Appropriations

Senate Subcommittee on Defense, Committee on Appropriations

Senate Committee on Armed Services

Senate Committee on Governmental Affairs

House Committee on Appropriations

House Subcommittee on National Security, Committee on Appropriations

House Committee on Government Reform and Oversight

House Subcommittee on Government Management, Information, and Technology,

Committee on Government Reform and Oversight

House Subcommittee on National Security, International Affairs, and Criminal Justice,

Committee on Government Reform and Oversight

House Committee on National Security

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Part III - Management Comments

Defense Finance and Accounting Service Comments



DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

SEP 25 1997


DFAS-HQ/AFC

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE,
OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT
OF DEFENSE

Subject: Audit Report on Defense Business Operations Fund
Adjustments at the Defense Finance and Accounting
Service, Denver Center (Project No. 5FD-2020.06)

We have reviewed the findings and recommendations identified
in the subject audit report and our comments are attached.

If additional information is required, my point of contact
is Mrs. Adrienne L. Ferguson on (703) 607-1581.


Edward A. Harris
Deputy Director for
Accounting

Attachment:
As stated

Defense Finance and Accounting Service Comments

**DFAS Response to the DODIG Findings and Recommendations in the
Audit Report on Defense Business Operations Fund Adjustments
at the Defense Finance and Accounting Service, Denver Center
dated July 15, 1997
(Project No. 5FD-2020.06)**

General Comments: The DFAS comments provided to the draft audit report are in response to some of the findings identified in the report and to the two recommendations directed to the DFAS. The DFAS comments also address a finding in Appendix B, which indicated that an agreed-to recommendation identified in a prior audit had not been implemented.

The DFAS recognizes that internal control weaknesses existed in its process of preparing and submitting accurate financial statements at the DFAS Denver Center. However, the DFAS has initiated several actions to provide more accurate CFO financial statements.

DODIG Finding for Controls Over DBOF Adjustments at DFAS Denver Center, Page 4: The DFAS Denver Center did not have adequate supporting documentation for 111 adjustments totaling \$217.5 billion made to the FY 1996 DBOF account balances of the Air Force, U.S. Transportation Command, and Joint Logistics Systems Center. In addition, for 90 of the 111 adjustments without adequate supporting documentation, the DFAS Denver Center did not develop an adequate written explanation for the adjustments. In many instances, adjustments were made to the same accounts because the amounts were recorded incorrectly, reversed, reestablished, decreased, or increased. The last nine adjustments without supporting documentation brought the Air Force DBOF Results of Operations from a loss of \$11 billion to a gain of \$2.2 billion, and the lack of audit trails contributed to the disclaimed opinion on the FY 1996 DBOF financial statements.

DFAS Response: Partially concur. The DFAS agrees that improvements in management controls over the processing of adjustments at the DFAS Denver Center are required to ensure that all journal vouchers are adequately documented. The DFAS does not agree that these journal vouchers were not supported by documentation. For all but 20 of the journal vouchers, the documentation existed and merely was not clearly and fully referenced on the journal vouchers. The implication of the DODIG statement that they "did not have adequate supporting

documentation" is that they were not supported and thus, there were \$217.5 billion in erroneous balances included in the Air Force DBOF financial statements. The DODIG report indicates that they could not determine the validity of the vouchers. Thus, the DODIG has not presented any evidence that any vouchers were not accurate and required. Further, the DODIG characterized these vouchers as "closing, crosswalk, reviewing, correcting, reclassifying, direct line, eliminating, other miscellaneous adjustments." In accordance with current DoD policy, many large journal vouchers are required to properly prepare the financial statements. For example, to determine the proper valuation of inventory and funds balance with Treasury and other financial statement values, significant source entry vouchers are required. These journal vouchers are not adjustments in the traditional sense but are source entry transactions. The description of all of these transactions as "adjustments" implies that all of the vouchers were input to correct errors. Whereas, most of the large dollar value vouchers are required by DoD policy as source entry transactions. These source entry transactions totaled \$131.9 billion. Thus, \$131.9 of the \$217.5 billion constituted this type of transaction. The report failed to make this important distinction. Also, the DFAS believes the DODIG focus on only the total amount of all the journal vouchers could mislead the reader to exaggerate the impact on the financial statements. Specifically, the net effect of all 124 journal vouchers that were processed was a reduction of \$6.1 billion in assets, an increase of \$185.6 million in liabilities, and a reduction of \$6.3 billion in equity. For a balanced presentation, the report should be revised to also recognize these outcomes of the vouchers processed. Finally, documentation supporting the last nine journal vouchers that were prepared to revise the FY 1996 Statement of Operations for the Air Force Supply Management business area was reviewed by various DFAS and Air Force officials. To our knowledge, the DODIG did not request or examine the supporting documentation for the last nine journal vouchers that are referenced in the report.

DODIG Finding for Controls, Page 6: The DFAS Denver Center did not adequately control the process for making adjustments to the accounts and to the financial statement line item balances. Controls were not implemented to ensure that adequate documentation supported the adjustments, and journal vouchers supporting the adjustments were adequately accounted for.

DFAS Response: Partially concur. The CFO Reporting System used to prepare the DBOF CFO statements vested approval authority for journal vouchers with the supervisor and one other designated person. Further, the authority to approve journal vouchers was controlled via security profiles assigned to specific personnel. Consequently, the journal vouchers that updated the financial statements were all approved by the designated personnel. In addition, the DODIG did not examine the extensive files supporting each version of the statements nor did they review the monthly AR(M) 1307 reports that are an essential part of the CFO reporting process. Finally, the DODIG did not examine the proofs and internal reconciliations among various statement balances that were forwarded to DFAS-HQ and the customer as evidence that the statements were accurate.

Despite these concerns with the report, we believe that all personnel who are responsible for preparing and approving journal vouchers should have a clear understanding of the requirements in DoD 7000.14R, Volume 6, Chapter 2, regarding an adequate audit trail for adjustments. Thus, the DFAS will change the current approval process for journal vouchers and add successive layers of approval for adjustments that exceed predetermined levels that we are developing. Furthermore, DFAS will add documentation of journal vouchers to the checklist that is being developed for the preparation of the CFO statements.

DODIG Finding on Supporting Documentation, Page 7, second paragraph: Additionally, a contractor developing the CFO Reporting System was allowed to make adjustments. One adjustment for FY 1996 business activity of approximately \$700 million was made by the contractor without approval by a DFAS official. In addition, 70 adjustments for FY 1995 business activity of over \$49 billion were also made by the contractor without DFAS approval.

DFAS Response: Nonconcur. The DFAS does not agree that the contractor adjustments were not approved by DFAS officials. The Statement of Work for the CFO Reporting System development included a tasking to have the contractor support DFAS Denver in the preparation of financial statements. The CFO Reporting System suffered a database problem and the contractor was contacted to correct the problem. To test the corrective action made by the contractor, a journal voucher was prepared by DFAS Denver personnel and given to the contractor for input into the system. During the whole process, the inputting was observed and

validated by DFAS Denver employees, including management. Further, the 70 adjustments for FY 1995 business were prepared by DFAS Denver staff accountants and approved by management and then input by the contractor because the journal voucher input screen was not yet completed. As a final check, the financial statements were reconciled with the AR(M) 1307 accounting reports, thus providing additional assurance of the accuracy of the reported data.

DODIG Finding for Supporting Documentation, Page 7, third and ninth paragraphs: The need for better control of adjustments is provided in the following example showing a series of adjustments Had adequate supporting documentation been provided, the appropriate adjustment could have been made in one entry.

DFAS Response: Nonconcur. There is a detailed process involved in preparing the CFO Financial Statements. Specifically, three versions of the statements must be prepared and all three versions have the same basic requirements of balanced statements. Journal vouchers D96081 and D96083 were prepared in Version 1. Journal voucher D96083 was prepared to bring the Statement of Cash Flow in balance with the Treasury fund balance. This adjustment completed Version 1 for the Supply Management Activity Group.

The other three journal vouchers, D96099, D96100 and D96102, were prepared 9 days later in Version 3 of the statements, after additional research and analysis were conducted by the DFAS Denver staff. In reality, journal voucher D96099 did not "reestablish the adjustment" as stated by the DODIG but was processed as a result of further reconciliations with the trial balances and AR(M) 1307 reports.

Moreover, journal voucher D96100 was a correction of the previous voucher D96099 that was entered incorrectly (\$12,694,681,287 should have been \$12,394,681,287). And journal voucher D96102 was a line 9 correction for the Statement of Cash Flow, not a correction to voucher D96081 (Version 1 entry). Instead, voucher D96102 was an additional line 9 cash flow balancing entry to finalize the Version 3 statements.

Obviously, the five journal vouchers could not have been processed in one voucher because they were in different CFO statement versions and vouchers were processed in between. Lastly, this finding assumes that journal vouchers and entries

Defense Finance and Accounting Service Comments

Final Repc
Reference

are being made off-line in a hard copy mode and summarized for entry into the system. In fact, the vouchers and entries are being made in a live environment (real-time) with a full audit trail of what happened moment to moment. The days when we could summarize and record after the fact without a full audit trail are gone.

DODIG Finding for Accountability for Journal Vouchers, Page 7:
The Journal Voucher Report, which is produced by the CFO Reporting System and should list all adjustments made, did not account for all journal voucher identification numbers. Each journal voucher number assigned to identify an adjustment should sequentially follow the last number used. Otherwise, an unauthorized adjustment could be entered into the system and have a greater chance of not being detected. The Journal Voucher Report for adjustments to FY 1996 DBOF business activity omitted seven voucher numbers, five of which were subsequently located.

Page 6

DFAS Response: Nonconcur. The DFAS Denver Center personnel have reviewed the file and accounted for each journal voucher used during the preparation of the FY 1996 DBOF financial statements. The CFO system issues journal voucher numbers sequentially. The numbers 1-125 were used except the number 20. Because of a problem with the CFO system, journal voucher D96020 was not used. The DFAS Denver personnel validated this fact along with the contractors to ensure that no adjustment was made to any general ledger account. Once the problem was corrected, the system began issuing journal voucher numbers again starting with D96021.

DODIG Finding for Guidance, Page 8: DFAS Headquarters and the DFAS Denver Center did not provide adequate written guidance to operating personnel for making adjustments at the DFAS centers.

Page 7

DFAS Response: Concur. The DFAS will ensure through training that all personnel responsible for preparing and approving journal vouchers have a clear understanding of the requirements outlined in DoD 7000.14R, Volume 6, Chapter 2, regarding an adequate audit trail for adjustments. DFAS Denver will change the current approval process for journal vouchers and add successive levels of approval for adjustments that exceed predetermined levels that we are currently establishing. Furthermore, DFAS Denver will add documentation of journal vouchers to the checklist that is being developed for the preparation of the CFO statements.

Defense Finance and Accounting Service Comments

DODIG Finding for Adequacy of Management Controls, Appendix A, Page 13: We identified a material management control weakness as defined by DoD Directive 5010.38 relating to the preparation of adjustments to the accounts and financial statement line items. Adequate controls had not been established to ensure the accuracy of financial information presented in the financial statements.

DFAS Response: Partially concur. The DODIG has not presented any evidence that the journal vouchers were not accurate. The DFAS did experience problems in preparing accurate FY 1996 Supply Management Activity Group CFO statements. However, general ledger crosswalk errors and unclear guidance for appropriately portraying prior period adjustments were the primary root causes. The DFAS Denver Center has since restated the FY 1996 Supply Management Activity Group CFO statements, corrected the crosswalk errors, and received guidance concerning the proper treatment of prior period adjustments.

DODIG Finding for Report No. 97-081, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," January 27, 1997, Appendix B, Page 14: We also recommended that the Director, Defense Finance and Accounting Service, correct the FY 1995 error in the FY 1996 comparative financial statements. Although the Deputy Chief Financial Officer agreed to the recommendations, the FY 1996 comparative financial statements did not include a correction of the FY 1995 error. As a result, the FY 1996 comparative financial statements were misleading.

DFAS Response: Nonconcur. The OUSD(C) memorandum of May 7, 1997, subject: Followup on OIG Report No. 97-081, "Appropriated Capital Used in the FY 1995 Defense Business Operations Fund Financial Statements," January 27, 1997, provided the current status of the recommendation. This memorandum also provided the documentation supporting the correction made to the FY 1996 CFO financial statement. A copy is attached to this response.

Recommendation 1: We recommend that the Director, Defense Finance and Accounting Service, issue written guidance for making adjustments. Such guidance should include procedures for providing:

- a. Adequate descriptions of the purposes for the adjustments.

b. Adequate supporting documentation.

c. Control and accountability for the assignment of journal voucher numbers.

DFAS Response: Nonconcur. The DFAS believes that adequate guidance currently exists in DoD 7000.14R, Volume 6, Chapter 2, for adjustments and journal vouchers. However, if the DODIG believes that additional guidance is required, this recommendation should be redirected to the OUSD(C). The FMR states that "The Heads of DoD Components shall not issue supplementary directives and/or regulations without the prior written approval of the Office of the Under Secretary of Defense (Comptroller)."

Recommendation 2: We recommend that the Director, Defense Finance and Accounting Service, Denver Center, establish procedures to ensure that:

a. Adequate descriptions are provided for all adjustments made.

b. Adequate supporting documentation is provided for all adjustments made. Such documentation should include sufficient evidence to provide an audit trail to the source transaction(s) requiring the adjustment.

c. Adjusting journal voucher entries are numbered consecutively and all voucher identification numbers are accounted for.

DFAS Response: Partially concur. As stated, we do not believe we have a significant problem describing, documenting, and controlling journal vouchers. However, DFAS will ensure that all supporting documentation for journal vouchers is either attached or cross referenced to identify the location of the supporting documentation. We will also add a statement to the effect "per form and content" or cite other authoritative sources on the face of the journal vouchers. And, to ensure that all employees responsible for preparing and approving journal vouchers have a clear understanding of the requirements in DoD 7000.14R, Volume 6, Chapter 2, regarding an adequate audit trail for adjustments, we will add documentation of journal vouchers to the checklist that is being developed for the preparation of CFO statements and change the current approval process for journal

Defense Finance and Accounting Service Comments

vouchers, adding successive approval levels for adjustments that exceed predetermined levels that are currently being established.

Estimated completion date: September 29, 1997.

Defense Finance and Accounting Service Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100



7 May 1997

MEMORANDUM FOR DEPUTY DIRECTOR FOR AUDIT FOLLOWUP, OFFICE OF THE
DOD INSPECTOR GENERAL

SUBJECT: Followup on OIG Report No. 97-081, "Appropriated Capital Used in the FY 1995
Defense Business Operations Fund Financial Statements," January 27, 1997

Attached is a response to your subject followup request.

The point of contact for this matter is Mr. Thomas W. Short. Mr. Short may be reached
by e-mail at short@ousdc.osd.mil or by telephone at (703) 697-6875 or DSN 227-6875.

/s/ Adolph

Ronald Adolphi
Deputy Director for Accounting Policy

Attachment

Attachment

**OFFICE OF THE UNDER SECRETARY OF DEFENSE (COMPTROLLER)
RESPONSE TO FOLLOWUP REQUEST**

**DoDIG Audit Report: Appropriated Capital Used in the FY 1995
Defense Business Operations Fund Financial Statements
Report No. 97-081, dated January 27, 1997**

* * * * *

RECOMMENDATION 2.a. We recommend that the Director, Defense Finance and Accounting Service implement the DoD 7000.14-R "Financial Management Regulation." requirement that proposed financial statements be compared with those of the prior period to identify any unusual trends, errors, inconsistencies, or departures from established accounting policies.

Published Response To Recommendation 2.a.: Concur. The DFAS has a process in place to review DBOF financial reports and identify any unusual trends, errors, inconsistencies, or departures from established accounting policies. The difference between the FY 1994 and FY 1995 financial reports was identified. Since no procedures were in place, at that time, to permit the recording of cash at the DeCA business area level, the \$940 million appropriation was included as a non-operating change in the non-expenditure transfer documents processed at the Treasury Department to establish the DBOF subnumbered accounts.

DoDIG Followup Request: The DoDIG requests a copy of the new procedures implemented to review DBOF financial reports and identify any unusual trends, errors, inconsistencies, or departures from established accounting policies.

Response to Followup Request: The DFAS has released two memoranda to its DFAS Centers that detail the policies and procedures to be used in a review of DBOF financial statements. One memorandum, dated October 18, 1996, is titled "Standard Requirements and Reference Information for Fiscal Year 1996 Chief Financial Officer Reports." A second memorandum, dated November 27, 1996, is titled, "Defense Business Operations Fund Chief Financial Officers Act Reconciliation Checklists." A copy of each memorandum is attached and identified as Appendix No. 1.

RECOMMENDATION 2.b. We recommend that the Director, Defense Finance and Accounting Service restate the Appropriated Capital Used and Non Operating Changes lines of the FY 1995 Consolidated Statement of Operations and Changes in Net Position shown in the FY 1996 comparative DBOF financial statements.

Published Response To Recommendation 2.b.: Concur.

DoDIG Followup Request: The DoDIG requests documentation which restates the FY 1996 comparative statements, the FY 1995 Statement of Operations and Changes in Net Position.

Response to Followup Request: Due to an uncertainty while the Department developed a policy on whether an appropriation should be shown in the DBOF business area (i.e., Commissary Operations) for which the appropriation was made or, alternatively, whether an appropriation should be shown in the DoD Component (i.e., Defense Agencies) to which the appropriation was made, the FY 1995 Statement of Operations and Changes in Net Position was not restated. The Department now has reached a decision that is in accord with the outcome intended by the audit recommendation. For FY 1996 and subsequent fiscal years, an appropriation made for Commissary Operations will be reported in the same manner as if it was made directly to that business area. Appendix No. 2 is a copy of the FY 1996 Statement of Operations and Changes in Net Position. That statement and its accompanying footnotes (most pertinent of which is Note 31C) verify this policy change.

RECOMMENDATION 2.c. We recommend that the Director, Defense Finance and Accounting Service report the departure from the applicable accounting principles for the FY 1995 Appropriated Capital Used account balance in the footnotes to the FY 1996 comparative DBOF financial statements.

Published Response To Recommendation 2.c.: Do not concur. The restatement of Appropriated Capital Used and Non Operating Changes of the FY 1995 Consolidated Statement of Operations and Changes in Net Position was the result of an error and not the result of a departure from accounting principles. An explanation of the error will be included in the footnotes to the FY 1996 comparative DBOF financial statements.

DoDIG Followup Request: The DoDIG requests the footnote in the FY 1996 comparative DBOF financial statements that explains the restatement.

Response to Followup Request: The requested footnote, note 31 to the FY 1996 comparative DBOF financial statements, is attached as Appendix No. 3

FISCAL YEAR 1996 DBOF COMPARATIVE FINANCIAL STATEMENT
EXCERPT FROM NOTE 31, "OTHER DISCLOSURES"

Statement of Cash Flows

	FY 1995	FY 1995 Restated	Difference
Line 20, Appropriations	\$ 177,732	\$1,117,870	\$940,138
Line 21.b., Transfers of Cash from Others	\$4,826,102	\$3,885,964	(\$940,138)

A Department of Defense, Inspector General (DoDIG) audit report titled, "Appropriated Capital Used in the FY 1995 DBOF Financial Statements," noted that the FY 1995 DeCA financial statements required corrections. Specifically, \$940 million was reported as a non-expenditure transfer instead of as a financing source. An adjustment was made to the FY 1995 financial statements, which restated this amount as Appropriations.

Appendix No. 3

Defense Business Operations Fund

Chief Financial
Officer
Consolidated
Financial
Statement
FY 1996

March 1, 1997

Defense Finance and Accounting Service Comments

Footnotes

Schedule E

Selling Activity:	Accounts Receivable	Revenue	Unearned Revenue	Collections
DBOF	\$ 76,942	\$ 1,232,455		\$ 562,235
Unearned Revenue				
Total	<u>\$ 76,942</u>	<u>\$ 1,232,455</u>	<u>\$ -0-</u>	<u>\$ 562,235</u>

Customer Activity:	Accounts Payable	Expenses	Advances	Disbursements
General Services Administration	\$ 6,572	\$ 197,873	n/a	\$ 193,155
Agriculture	127	99	n/a	185
Interior	1,450	1,924	n/a	477
NASA	12,637	38,941	n/a	199
State	22	50	n/a	40
Transportation	449	2,337	n/a	3,722
Treasury	113	958	n/a	1,488
Veterans Affairs	16	93	n/a	99
Justice	180	106	n/a	58
Federal Emergency Management	1,694	145	n/a	141
Defense Security Assistance Agency		328,097	n/a	328,097
Other	53,682	661,832	n/a	34,574
Advances				
Total	<u>\$ 76,942</u>	<u>\$ 1,232,455</u>	<u>\$ -0-</u>	<u>\$ 562,235</u>

Note 30. Contingencies (Not applicable.)

* Note 31. Other Disclosures

Problem Disbursements:	1995	1996	Change	Percentage Change
DBOF (T.I. 97) Appropriations				
Unmatched Disbursements	\$ 1,912,037	\$ 815,076	\$ 1,096,961	57.37%
Negative Unliquidated Obligations	123,969	52,226	71,743	57.87%

The data shown on this chart is a consolidation of data as reported by the individual services and agencies. Some entities reported no data for FY 1995 or data in only one category. As a result, the figures reported for FY 1995 are probably low. The actual decrease from FY 1995 to FY 1996 is probably greater than depicted.

Footnotes

Net Position:

The reported Navy DBOF Supply Management Net Position is calculated using a USD(C)/DFAS-HQ model. Several invested capital accounts that were once considered Transfers-in and Transfers-out were crossed to allowance accounts in the model and used in the Latest Acquisition Cost calculation. Cumulative Results of Operations, line 7C, is also calculated by the model. The total includes an adjustment of \$444 million that is formula driven keeping a journal voucher entry in balance. In addition, because of methodology changes imposed by the model line 7C (FY 1996) does not equal Line 7C of prior year on the Statement of Financial Position plus current year net operating results, Line 16, plus current year adjustments, Line 20 of the Statement of Operations and changes in Net Position. Net Position, Beginning Balance, as previously stated, Line 19 does not equal the ending position of FY 1995. This is a result of changes in methodology as contained in the model.

*** Restatement of Prior Year Principal Statements:**

The fiscal year 1995 DBOF Principal Statements have been restated in the following areas:

Statement of Financial Position

	<u>FY 1995</u>	<u>FY 1995 Restated</u>	<u>Difference</u>
Line 1.d., Inventory	\$55,260,195	\$59,887,675	\$4,627,480
Line 1.g., Stockpile Materials	\$ 4,780,335	\$ 152,855	(\$4,627,480)

The revised OSD Form and Content guidance required War Reserves material to be reclassified as inventory. The reclassification was done for all Supply Management business areas with the exception of the Navy.

Statement of Cash Flows

	<u>FY 1995</u>	<u>FY 1995 Restated</u>	<u>Difference</u>
Line 20, Appropriations	\$ 177,732	\$1,117,870	\$ 940,138
Line 22.b., Transfers of Cash from Others	\$4,826,102	\$3,885,964	(\$ 940,138)

Footnotes

* A Department of Defense, Inspector General (DoDIG) audit report titled, "Appropriated Capital Used in the FY 1995 DBOF Financial Statements," noted that the FY 1995 DeCA financial statements required corrections. Specifically, \$940 million was reported as a non-expenditure transfer instead of as a financing source. An adjustment was made to the FY 1995 financial statements, which restated this amount as Appropriations.

In addition to these reclassifications, there were some other reclassifications made at the DoD Component or business area level which are not reflected on the Principal Statements. These reclassifications in most cases are identified in the individual business area financial statements and the differences are identified in the DoD Component or business area notes to the financial statements.

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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Stephen J. Szabanowski
Deborah Curry

INTERNET DOCUMENT INFORMATION FORM

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